U.S. Economic Outlook:

Strong Economic Growth Driven by GOP Tax Policy

- The U.S. economy has been **expanding** for over 27 months, since the fourth quarter of 2001.
- **Job growth** always lags other economic indicators in a recovery. However, the U.S. economy has been adding jobs since at least July 2003.
- **Inflation** has been extremely **low** and **productivity** extremely **high** for the last two years.
- **Exports increased dramatically** in 2003, up 19% in the final quarter of 2003.
- **Tax cuts** enacted in 2001, 2002 and 2003 have provided a critical and significant boost to personal disposable income, retail sales, business investment and small business income.
- **The manufacturing sector** has emerged from its recession and is on a clear upward trend. Employment in manufacturing will continue to rebound in 2004.

Prepared by the Committee on Ways and Means

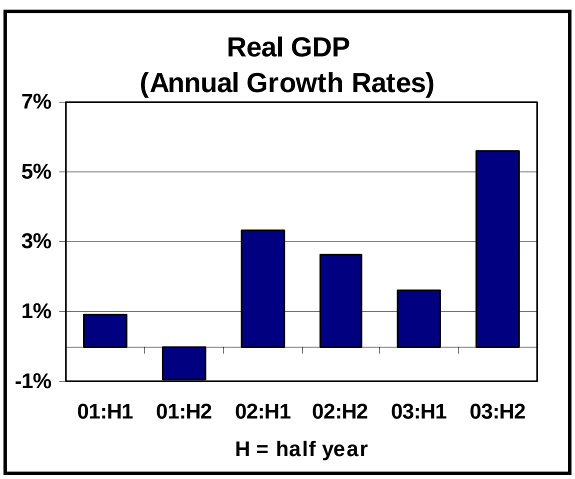
February 2004

Committee on Ways and Means
State of the Economy – February 2004

Despite mixed reports in the media, the U.S. economy has been performing extremely well for several quarters. Overall output is expanding, productivity growth is strong, investment spending has rebounded, and both interest rates and inflation remain very low. The employment situation generally appears very positive with a declining unemployment rate (now 5.6 percent, down from 6.3 percent in June 2003) and many indicators of job creation. The household survey jobs data has been positive since late 2002. One set of federal job statistics (the payroll survey) however has yet to report significant job growth. Most economists expect an upward revision to the recent data in this survey and stronger results in coming months.

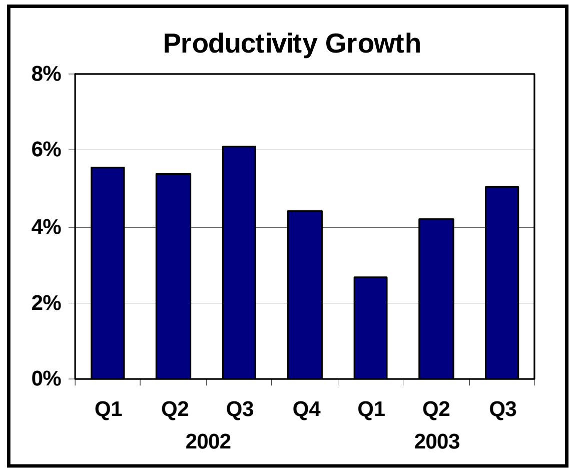
Pro-growth tax cuts, particularly lower marginal tax rates and incentives for investment (accelerated depreciation, small business expensing, lower capital gains taxes and reduced tax on dividends), have spurred stronger growth and helped fuel the economic recovery.

GDP. The U.S. economy has been expanding since the fourth quarter of 2001. The average rate of real growth has been 3.5 percent, notably above the historical average of 3.1 percent.

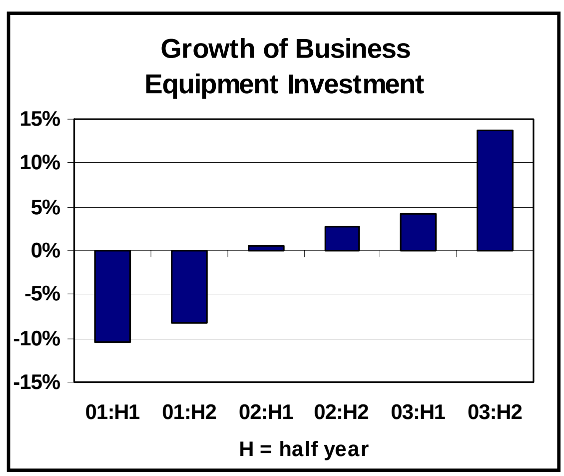


Spending on personal consumption (particularly durable goods such as autos and appliances), business investment, residential construction and exports are increasing rapidly.

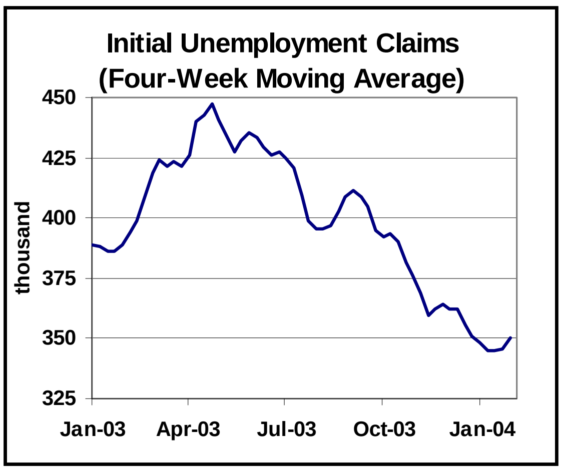
Productivity. Growth has been driven by strong increases in productivity (output per worker-hour). Productivity has increased 5 percent annually for the last two years compared to growth of just 1.4 percent per year from 1973-1995. Although this blistering rate of growth is unsustainable in the long run, it is possible that relatively fast productivity gains will continue for the near term. Faster productivity growth leads directly to high standards of living for future generations.



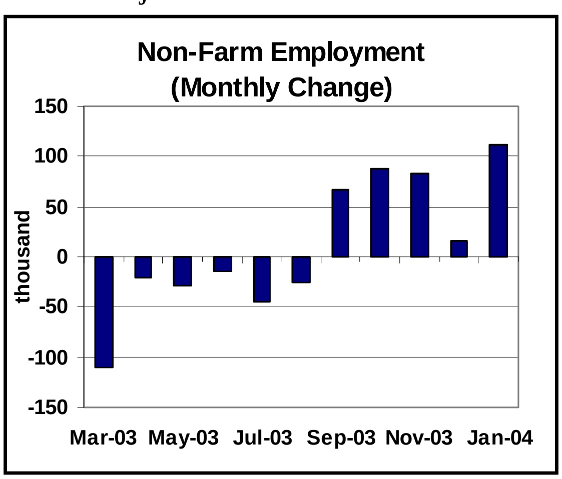
Investment. Growth has also been fueled recently by a rebound in capital investment. The mild recession of 2001 can be best characterized as the result of a drop off in business investment spending. Smart, well-timed tax cuts such as the accelerated depreciation and lower marginal rates for small businesses have encouraged firms to make more capital investments. These changes have helped reinvigorate investment and will help the economy continue to expand through 2004 and beyond.



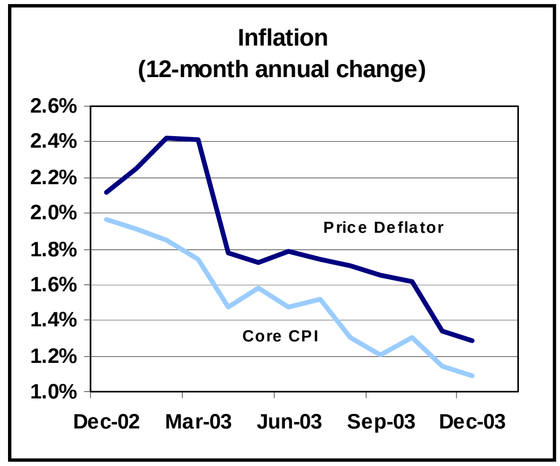
Labor. Labor markets began to improve in the final quarter of 2003 and are expected to expand more rapidly in 2004. Initial claims for unemployment insurance continue to decline and are now at the lowest level in three years. At its current level, approximately 350,000 new claims per week, the economy typically adds 150,000 – 200,000 jobs per month. In addition, surveys of small business and manufacturing firms both indicate a rebound in employment. NFIB's employment survey index rose to the highest level since 2000. National Association of Manufacturers estimates 250,000 manufacturing jobs will be created in 2004.



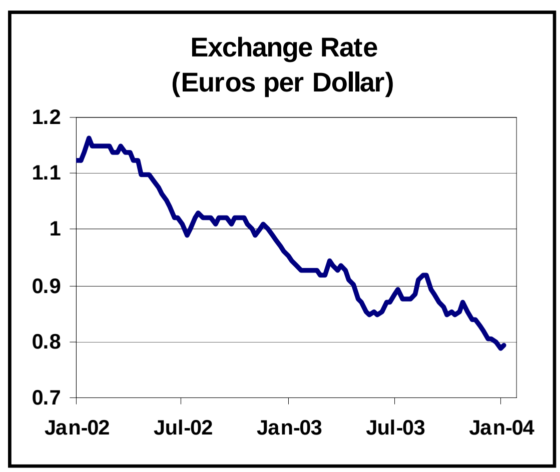
Some labor market statistics have yet to show strong signs of improvement, notably the payroll survey, which has only begun to improve. However, an analysis of the employment data in aggregate points to a rebound in jobs.



Inflation. Inflation has been extremely low in recent years which has allowed the Federal Reserve to keep short-term interest rates at 1 percent. There is more than one way to measure inflation but all indicators suggest very moderate price growth. Inflation will be a key indicator to watch in 2004.

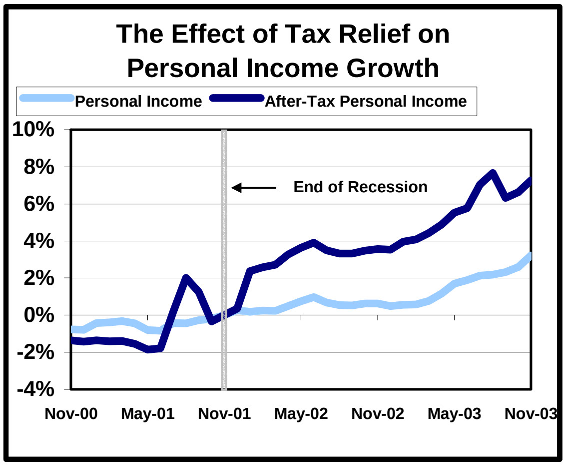


The U.S. Dollar and U.S. Trade. The decline in the dollar against foreign currencies will be a boost to exports and the manufacturing sector. It now costs 0.80 Euros to buy $1, down from $0.94 a year ago. Total U.S. exports in 2003 were $1.1 trillion and exports jumped 19.1 percent (annual rate) in the fourth quarter of last year.



Recent Tax Cuts Boost the Economy. Well-timed tax relief has greatly mitigated the effects of the recession and raised the standard of living for all Americans.

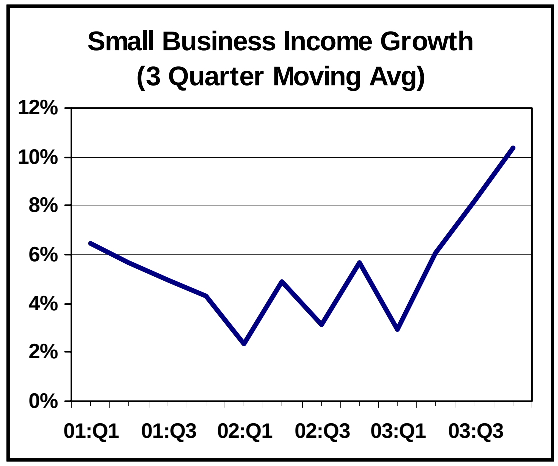
Tax Cuts Boost Personal Incomes. Aggregate personal income generally slows during a recession and the most recent was no exception. For the most recent recession and recovery period this trend is especially pronounced. Because the employment recovery has lagged well into the recovery, personal income growth has been weaker than in previous post-recession periods.



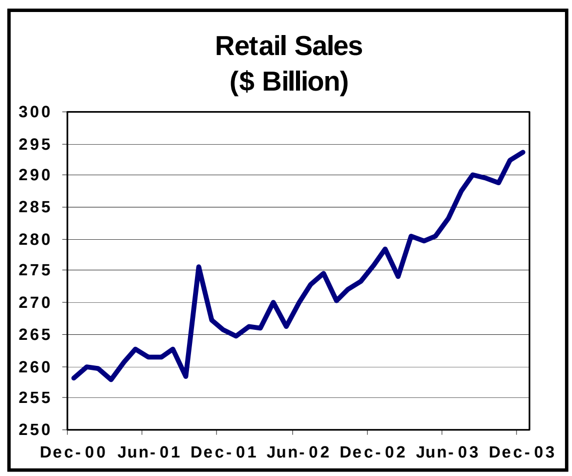
However, it is not *gross* personal income but rather *after-tax* personal income that matters most to consumers. As the chart below illustrates, the tax relief passed in 2001, 2002 and 2003 lifted after-tax personal income while pre-tax income languished.

Tax Cuts Boost Investment. Business investment spending swung wildly from a drag in 2001 to a net contributor to growth in the most recent quarters. In the second quarter of 2001, weak investment spending lowered growth by 1.6 percentage points while in the third quarter of 2003, the investment boom added 1.3 points to the quarterly GDP estimate. During that period, the tax on capital investment has been reduced dramatically: bonus depreciation of 30% enacted in 2002 was boosted to 50% in 2003; the capital gains tax rate was cut from 20% to 15%; and the taxation of dividends, which are the proceeds from capital investments – was cut from a maximum of 38.6% to just 15%.

Tax Cuts Boost Small Businesses. Tax cuts enacted in 2001 and 2003 lowered the marginal tax rate on 23 million small businesses. As the first chart below indicates, incomes from non-farm proprietor's income (small, unincorporated businesses) have been accelerating for over six months.

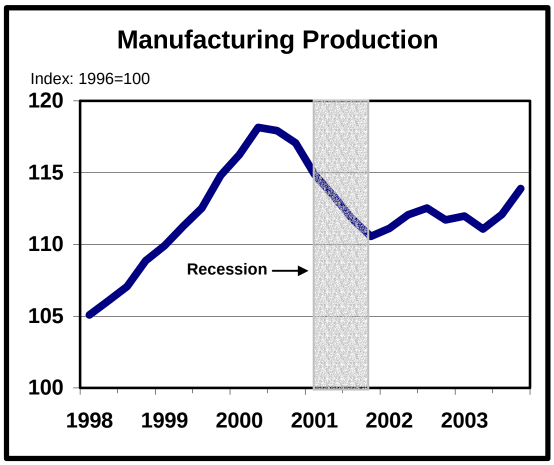


Tax Cuts Boost Consumer Spending. $35 billion in rebate checks were sent to 83 million taxpayers in 2001. In 2003, 25 million families received checks totaling $14 billion due to the increase in the child tax credit. These tax rebates combined with the reduction in marginal tax rates have helped boost consumer spending.

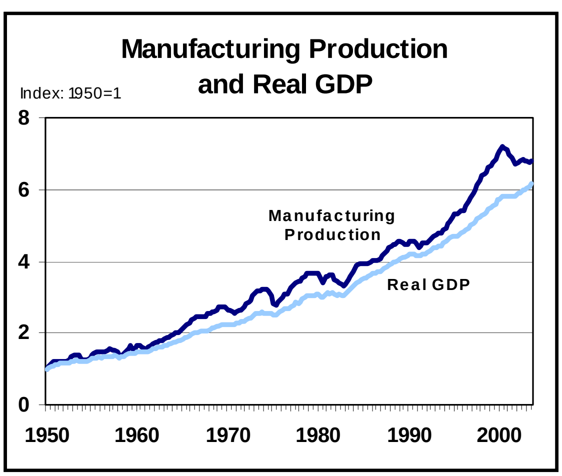


Manufacturing Sector. The manufacturing sector produces approximately 14 percent of the total U.S. economy in terms of gross output. It is one of the most dynamic sectors of the economy, undergoing rapid change due to technological innovation, globalization and business reorganization. Employment in manufacturing, like many segments of the economy, has shifted significantly in recent years.

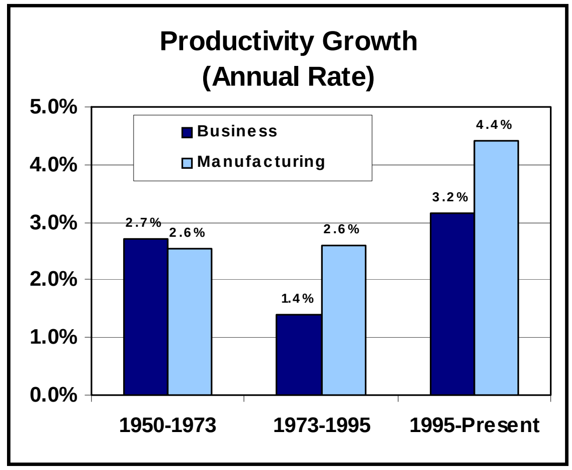
Output. Output in the manufacturing sector declined during the recession of 2001 and has since begun to rebound. According to Federal Reserve Board data (see chart below), manufacturing production has been increasing for 7 months. The improvement is a result of a return to business investment in new machinery and strong consumer demand for durable goods.



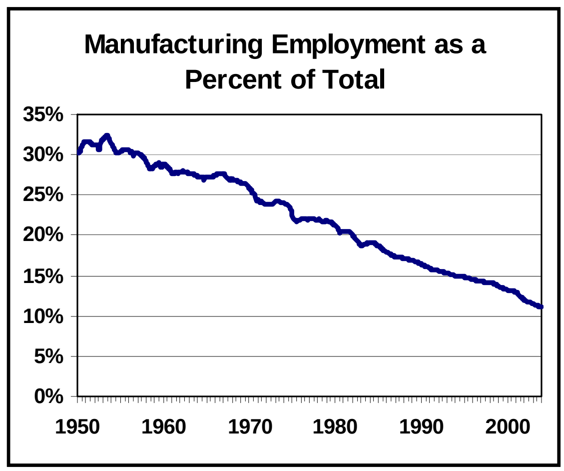
Manufacturing has historically grown faster than the overall economy. Since 1950, manufacturing output in the United States has increased 680% while the overall economy has grown 620%.



Manufacturing Productivity. Output in the manufacturing sector has outpaced the overall economy because of larger increases in productivity. Output per worker and output per hour in manufacturing have both increased dramatically as a result of new technology.



Employment. Employment in manufacturing has declined notably in recent years but this is part of a long-term historical trend as the economy shifts towards increased production in the service sector.



As the economy continues to expand in 2004 and beyond, the manufacturing sector will expand more rapidly as well. GOP-led efforts to reduce the tax on capital through lower marginal rates on capital gains, dividends and small business income as well as strong investment incentives will be an important contributor to growth in this sector.

Note: Data in charts provided by Bureau of Labor Statistics, Bureau of Economic Analysis and the Federal Reserve Board.